No. 77-832

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,

Petitioner,

vs.

FIRST LINCOLNWOOD CORPORATION,

Respondent.

On Writ Of Certiorari To The United States
Court Of Appeals For The Seventh Circuit

BRIEF OF THE RESPONDENT

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BRIEF OF THE RESPONDENT

May It Please The Court:

QUESTIONS PRESENTED

We do not agree that the question under review is correctly presented at page 2 of the Petitioner's Brief; we perceive the questions presented to be:

1. Whether the Federal Reserve Board may deny an application to form a new bank holding company except by reason of some effect or result which will arise by reason of the completion of the transaction in question.
2. Whether the Federal Reserve Board has the power under the applicable statute to disapprove the formation of a one bank holding company when the formation of that company will, in no respect, change any of the relevant circumstances of the bank except for the better.
3. Whether the Federal Reserve Board acted arbitrarily and capriciously in denying bank holding company status when the only effect of the formation of the bank holding company will be to allow to the ownership of the bank a certain tax benefit available to substantially all other persons in similar circumstances.

STATEMENT

The Petitioner's Brief describes the transaction by which First Lincolnwood Corporation would seek to become a one bank holding company under 18 USC Sec. 1841, owning the First National Bank of Lincolnwood. It is agreed that "there would be practically no realistic difference in the financial operation of the bank" if owned by the proposed holding company and that operation through a holding company "might be financially sounder." Pet. App. 28a. There is no contention that operation as a holding company would be less sound.

The essentials of the holding company transaction are:

1. The stock, presently held in a voting trust, would be transferred to the one bank holding company, which would then perform the same function as the voting trust; it would hold the stock, and would, as required, vote it for the election of directors. Since the same individuals would be in control after as before, there would be no change in management.
2. The holding company, with personal guaranties, would be liable for debt of $3,697,000. In addition, the principals would raise, and, through the holding company, purchase additional stock of the Bank in the amount of $1,071,875. (App. 35). The debt is not new debt; it was incurred when the individuals bought control of the Bank from a former group which found itself in criminal difficulty. (App. 29) The holding company transaction creates no new debt, and denial of holding company status will not remove debt already incurred.

3. In addition, the Bank itself would increase its capital by the issuance of capital notes, as approved by the Comptroller, in the amount of $1,000,000. (App. 51).
4. The debt assumed would be paid off from the dividends and tax transfer payments allowed by law and approved by the Comptroller. These earnings are considered "sufficient to retire" to "acquisition debt." (App. 32). (Report of FRB Chicago[1]).

The transaction, called a "formal restructuring" in Petitioner's Brief (Pet. Br. 4) would increase the capital accounts of the bank by $2,000,000, and would, prospectively, save the Bank at least $130,000 per year in income taxes.

No adverse factors whatever have been claimed to exist which are caused or brought into being by the transaction itself.

The holding company itself is an Illinois corporation formed for that purpose; it has engaged in no actual business. (App. 30).

The Bank had, at the end of 1974, total assets of $71,000,000, and had "low capital ratios" which reflected "the cumulative effect of many years of litigation fees and substantial loan charge-offs, which reportedly resulted from questionable loans and advances made to certain directors (and their interests) no longer associated with the Bank." (FRB Chicago Report, App. 27). Those are the adverse interests whose shares were purchased with the borrowed money which is now the basis for refusal of holding company status.

The Bank was formed in 1955, in Chicago, and moved to Lincolnwood (a neighboring suburb of Chicago) in

[1] The Federal Reserve Bank of Chicago is referred to in this brief as "FRB Chicago".

1962. It is regularly examined and regulated by the Comptroller of the Currency. (App. 25) 12 USC § 481.

The Bank's loan policy is described as "conservative" (App. 25), and its "overall asset condition appears sound." (App. 26).

Due to the elimination of the former interests the directorate had been recently changed at the time of the application, but "the directorate appear(ed) attentive and active, and their collective efforts are demonstrated in the excellent growth and earnings pattern the Bank is currently experiencing." (App. 29 FRB Chicago Report).

According to FRB Chicago, the present management, through its President, Harold Cohn, "successfully converted Bank's operation from a chronic problem condition to the present favorable posture." (App. 29). As to the quality of management, the Court of Appeals said in the panel opinion (Pet. App. 19a):

> "All parties now agree that the bank's present management . . . is outstanding and has converted the bank to its now favorable condition."

The operation of the Bank through a voting trust is said to have had "a favorable impact on improving Bank's financial condition" (App. 23), and the infusion of new capital from the formation of the one bank holding company would serve the public convenience by increasing the loan limits of the Bank. (App. 33).

Holding company status was first sought with the presentation of a proposed application to FRB Chicago on November 15, 1974. Filing was finally acknowledged June 3, 1975. The Federal Reserve Board of Chicago and the Comptroller of the Currency approved by September 26, 1975. Denial came on January 9, 1976, and these proceedings followed. (12 USC § 1848). The tax savings

lost to the Bank since filing are approximately \$426,240,[2] and continue.

The holding company did not propose to engage in any business which required Board approval (App. 15), or in any non-banking activities of any kind. (App. 15). Illinois forbids branch banking in every form, as well as multi-bank holding companies, and this one bank holding company will be bound by Illinois law. Ill. Const. 970, Art. 13, Sec. 8; Ill. Rev. Stats. Ch. 16½, § 106; 12 USC § 36.

The Seventh Circuit's affirmance of the Board was by a divided panel. (Pet. App. 15a). On rehearing, with seven judges participating, the Court unanimously reversed the Board, holding that the Board should not deny holding company status when the "condition or tendency deemed not to be in the public interest" will not be caused or enhanced by the proposed transaction. (Pet. App. 7a).

[2] This figure is calculated as follows: Interest on \$3,700,000 at 8% per annum is \$296,000. The Bank earns more than the minimal amount, and pays a 48% tax. This indicates an annual tax on this fund of \$142,080 (.48 x 296,000). It has been three years. (3 x 142,080 = \$426,240), and this footnote is written on the third anniversary of the application. The legal basis for the tax savings is as described at Pet. Br. p. 5, note 3, and the tax effect of the proposed transaction is not in dispute. The \$130,000 figure used in the briefs below as the annual tax saving was based on the lower interest rate then prevailing.

SUMMARY OF ARGUMENT

The summary of argument in the Petitioner's Brief presumes that this bank holding company exists in a state which allows branch banking, chain banking, and the conduct of non-banking business by a holding company.

None of those factors apply to this case; the principal purpose of this bank holding company is to file a consolidated tax return, so that the Bank may remain an independent local entity. Any other business would be entirely at the discretion of the Board. And, no Illinois holding company may own more than one bank, and that bank may have no more than one banking house; this transaction cannot be the prelude to any form of "branch" type banking.

The legislative history of bank holding company regulation says that the purpose was, first, to avoid undue concentrations of power through the use of the bank holding company mechanism to achieve the equivalent of unregulated branch banking, and, second, to avoid the mixture of banking business with business unrelated to banking. The regulation of bank holding companies by the Federal Reserve Board, like the regulation of bank mergers, is designed to preserve competition and avoid the use of deposit funds as a competitive tool in the conduct of non-banking enterprises.

The statute itself, (Pet. Br. p. 2) 12 USC § 1842, is plain; in subsection (c), there are two enumerated factors to be considered, drawn without substantive change from the Bank Merger Act; the two factors pose the inquiries which the Board must make; without satisfactory answers to both, then the statute commands that the "Board shall not approve." In making this decision—an anti-trust decision tempered by community

needs—the "financial and managerial" resources are to be considered—as set forth in the last paragraph of subsection (c). But, the decision remains an anti-trust decision, with considerations in favor of the proposed transaction not made in cases under the Sherman and Clayton Acts because of the basic differences between banking and commerce. (15 USC § 2; § 17 et seq.).

The decision of the Board, under any standard, was arbitrary and capricious. The effect of the transaction is that nothing changes except that the ownership of the Bank will be more likely to pay off the debt against the ownership more promptly if the transaction is made than if the transaction is not made. The transaction makes no change at all in any legal relationship that affects either the banking community or business in Lincolnwood, Illinois. It is an arbitrary act to deny a valuable status where the granting of that status would do no harm to anyone.

The Federal Reserve Board should not use its authority to grant or withhold holding company status as an instrument of money policy, and should not use it to reward or deny reward for obedience to capital requirements for one bank holding companies found no place in the law. These Respondents, as all others, are entitled to some reasonable certainty in the law, and should not be denied holding company status because, as a part of its overall regulatory authority, the Federal Reserve Board deems it unwise to allow a bank holding company on a particular date. This is not an appropriate case in which the Federal Reserve Board should use its unreviewable money policy discretion; it is a case in which the Board should be held to an ascertainable legal standard; such a standard was found and applied by the Court below, and should be confirmed here.

We contend that the decision below is right, and that the result is right, and that the Respondent should be allowed to proceed with its holding company transaction.

ARGUMENT

I.

THE DECISION OF THE SEVENTH CIRCUIT COURT OF APPEALS IS RIGHT.

We submit that the decision below is well reasoned, correct and that the best argument in support of the decision is the opinion itself. The Board should not be allowed to disapprove the formation of a one bank holding company when it cannot demonstrate any difference at all in the banking situation, in the public convenience or in the competitive factors before or after the formation of the holding company.[3]

Counsel for the Board conceded below that the formation of this holding company would make no difference; his words were paraphrased by Judge Fairchild (Pet. App. 28a):

> "On oral argument, counsel for the Board twice admitted that there would be practically no realistic difference in the financial operation of the bank whether it was owned by private individuals or allowed to operate through a bank holding company. Indeed, counsel went on to concede that operation under a bank holding company might be financially sounder in the instant case as a result of approximately $130,000 in annual tax savings that would be possible because of the opportunity to file a consolidated tax return."

[3] One bank holding companies, as opposed to the multi-bank holding companies found in States allowing branch banking, have been commonly "organized by families or individuals to control small banks while at the same time gaining certain tax advantages offered by incorporation." Economic Perspectives, March-April 1977; "Non Banking Activities of Bank Holding Companies" (Published by FRB Chicago). The Board has claimed that it exercises its discretion in favor of one bank holding companies designed to preserve a continuity of good management, to help maintain the independence of small, community banks. *Central States Bancorp*, 39 Fed. Reg. 31,952.

As against this concession, the Board now seeks reversal because it says that it "need not allow the creation of financially unsound bank holding company systems." (Pet. Br. p. 13).[4] Its actual position, as stated to the Seventh Circuit, is that it has the right to disapprove any transaction if it chooses to do so, being obliged only to characterize its action as in the "public interest." This is the only standard which, by regulation, the Board has accepted. 12 CFR 262.3(d).[5]

To attack the opinion below, the Board goes far beyond the facts of this case, ignores the approval of the transaction by the staff of the Federal Reserve Bank of Chicago (App. 21), and argues that the opinion below will result in terrible consequences. We contend that this case should be judged on this record, and not on the basis of "future horribles" such as were rejected as the basis of decision by the trial judge in *U.S. v. First National Bancorporation*, 329 F. Supp. 1003, 1016 (D. Colo.), affirmed (by an evenly divided court), 410 U.S. 577. And, it is plain, as identical language in the Bank Merger Act was applied in *U.S. v. Third National Bank*, 390 U.S. 171, 190, that the statutory words referring to "financial and managerial resources" [18 USC 1842(c)] are to be applied as they relate to a particular transaction, and not to some abstract concern for what might

[4] This case does not involve a "financially unsound bank holding company system;" the Board's brief overlooks the emphatic findings of good management at the bank, and the report of FRB Chicago that this holding company plan would improve capital retention and benefit the Bank. App. 21, 23, 30. The Board also ignores the Comptroller's approval, and the lack of any other objection. See App. 51. The Board's adverse finding is undercut by the views of the two Federal agencies best able to consider the prospects of success of the proposed holding company.

[5] "The Board takes such action as it deems appropriate in the public interest." 12 CFR 262.3(d).

occur at some other time under some other circumstances.

We emphasize that the FRB Chicago report says that "The holding company structure will enhance bank's prospects for capital retention." (App. 23). This transaction takes united control ownership of a bank, now exercised through a voting trust (App. 58) and allows those same functions to be performed through a holding company. There is no real change by reason of the transaction, except for the better.

Against this simple transaction, the Board raises these "future horribles," which we answer:

1. That there would be a "strain on the Bank in servicing the holding company's heavy acquisition debt." This is a "straw" argument; the Bank does not owe the debts of the holding company and does not assume those debts by this transaction. As a regulated entity, the Bank must have a dividend policy consistent with the statute, 12 USC 60, and, under some circumstances, may only pay a dividend with the approval of the Comptroller of the Currency. 12 USC Sec. 60(b). No other "strain" exists, and the FRB Chicago report contradicts the Board's unsupported finding by noting that the formation of the holding company will "enhance capital retention." (App. 23).[6] Further, the individual owners must, as a matter of simple mathematics, be under far greater pressure to declare dividends without a holding company than with a holding company.

[6] The Board claims that a holding company should be a source of strength for its bank. This is not the effect of holding company affiliation, and is not even a rational goal; it is so revealed in a study entitled "Effects of Holding Company Affiliation on De Novo Banks" published in "Business Conditions," July 1976, by FRB Chicago, p. 15. The economic benefits of bank holding companies studied in Staff Economic

(Footnote continued on following page)

The transfers of a tax equivalent sum would be effected under 26 USC 1501 and 26 CRF 1.502-14(a)(1) (1976), and would be in the amount of the tax savings realized by the Bank as a result of the filing of a consolidated tax return with the holding company. The only "strain" from that transfer would be the "strain" of disbursing a sum equal to what would have been disbursed as taxes. And, if such a transfer were not made to the holding company, the savings to the Bank would increase capital. In no respect would the Bank suffer any financial injury.

2. "A bank holding company may expand into banking related activities with Board approval." (Pet. Br. p. 16). This is true; but if the Board is concerned about "other activities," then the Board may deny permission for "other activities" if that permission is sought. And, the application itself says that the Bank "does not anticipate at this time engaging in any nonbanking activity that requires separate Board approval." (App. 15).

3. "The holding company may avoid the strictures of state laws that restrict branch banking." (Pet. Br. 16). Illinois Law (Ill. Rev. Stat. Ch. 16½, § 106) forbids any form of branch or chain banking, or the ownership of more than one bank by a holding company. Ill. Rev. Stat. Ch. 16½, § 72-74. There is no possibility that the Bank will use the holding company device to avoid Illinois law—there are no branch banks in Illinois, and no holding companies with more than one bank. The Comptroller is forbidden to allow a branch. 12 USC § 36. This objection simply has no merit.

[6] *continued*
Study 84. "The Performance of Individual Bank Holding Companies," Arthur G. Fraas; found at the Library of FRB Chicago. See also: Staff Economic Study 90. No statute has been passed by Congress making any requirement that the bank holding company be a "source of strength" to the Bank, and there has not been any requirement that any individual owner of bank stock be a "source of strength" since the termination of the disastrous double liability statutes. See 12 USC § 64a.

4. The holding company "may acquire funds without regard to the interest ceilings and reserve requirements that apply to banks." (Pet. Br. 16). The issuance of securities by the holding company will be subject to the securities laws of Illinois, and, in all probability, the United States. And, the holding company, after formation, is a regulated entity. The legal protections to the public from misuse of the holding company for the sale of securities is substantial, and the penalties for such abuse are severe. There is no reason to presume that these owners, who are praised by FRB Chicago for their management of the Bank, will become dishonest when the holding company is formed. (See App. 29, 30).

5. "[T]he holding company device . . . could be used to concentrate control of ownership." (Pet. Br. 17). The Board explains how this could occur in footnote 16, p. 17, of its Brief. Essentially, this could be achieved only by forfeiting the tax benefit which is the primary reason for the transaction, and reducing holding company ownership below 80 percent, thus losing the right to file a consolidated tax return. This would defeat the purpose of the transaction, and is most unlikely to occur.

6. "[T]o discourage speculation in bank stocks" (Pet. Br. p. 12). With a holding company owned by four people owning 80 percent of the shares of a small bank—which it must continue to hold to comply with the requirements for filing a consolidated tax return—there is no chance at all that this particular holding company will be "an attractive vehicle for speculation in bank stocks", (Pet. Br. p. 12), or that it will engage in "speculation". The individuals are engaged for

the long term in the ownership of this Bank, and the purpose of the holding company is to protect that ownership.

7. "[T]he holding company device may lead to a drain on the bank's resources." The direct regulation of the bank, as to dividends, and in every other respect, by the Comptroller puts aside this objection. See 12 USC §§ 26, 27, 57, and 60. The Federal Reserve Board has expressly abjured the direct regulation of banks held by holding companies. 1970, U.S. Code Cong. & Adm. News, p. 5548 (Statement of Chairman Burns). The Federal Reserve Board has fully ceded the examination of national banks to the Comptroller. 63rd Annual Report, Federal Reserve Board, p. 412 (1976). The "drain," if any, is the concern of the Comptroller; his plenary supervisory powers will protect the Bank.

The Board should not, under the existing statute, be accorded power beyond a consideration of the transaction in question, and the effects of that transaction, and then its power should extend only to the limits of the statute. 12 USC 1842. We contend that this statute (Pet. Br. pp. 2-3) does not authorize a denial of the substantial tax benefits of holding company status where no possible harm can be mentioned or even claimed by the Board either to the public or to the entities involved. See *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

We add that the statute (12 USC 1842) does not describe what shall be required of the capital structure of a bank holding company. In the case of a bank, there is a precise description of the capital requirements for commencement, 12 USC § 51, and the Comptroller of the Currency is given precise regulatory power. See: 12 USC § 36. there should be no reason to presume some

grant of power where it is not specifically given as to the holding company, and when the power to regulate the capital requirements in banks is so specifically given. Nothing in the legislative history indicates a Congressional intent to specify the amount of capital required to be a bank holding company, and the Federal Reserve Board has passed no regulation making any discernable capital requirement.

We submit that the attack on the opinion below is based on illusory hypotheses, and that the opinion is correct, and should stand.

II.

THE LEGISLATIVE HISTORY SUPPORTS THE DECISION BELOW.

The legislative history, outlined in the opinion below (Pet. App. 6a, *et seq.*), demonstrates that bank holding company legislation was initially passed and then amended for two purposes:

1. To apply anti-trust standards to the expansion of multi-bank holding companies, and
2. To terminate the entry of both one-bank and multi-bank holding companies into businesses not related to banking. It was, and remains, the intent to avoid the creation of the "zaibatsu" style of banking-industrial combination that exists in certain other countries,[7] and to preserve the "traditional separation of banking and commerce." 1970, U.S. Code Cong. & Adm. News, p. 5549 (Statement of Chairman Burns).

The Bank Holding Company Act of 1956 came to be as the result of intensive lobbying on behalf of the Independent Bankers Association. 101 Cong. Rec. 8020. A prin-

[7] See: *Non Banking Activities of Bank Holding Companies*, Economic Perspectives (a publication of FRB Chicago), March-April 1977, p. 13.

cipal sponsor of the bill, (Congressman Spence) in his presentation of it, argued:

> "If you concentrate money and credit in the same hands, you have an impregnable monopoly. That is the effect of the holding companies today. Just imagine what chance you would have if you were a small businessman in a community where the holding company controlled the bank and also a competing business. There is no doubt about what would be your ultimate fate. We think that the holding companies are a dangerous thing to our economy, that the centralized concentration of economic power is just as dangerous as the concentration of political power."

Describing bank holding companies, Mr. Spence also said:

> ". . . through the bank holding company device the banks are really not only in the business of banking but they not only own the stock of but absolutely control unrelated businesses. In that way they are given a very great advantage over independent banks." (101 Cong. Rec. 8021).

Congressman O'Hara of Illinois said that "banks should stick exclusively to banking and should be as free from non-banking interests as Caesar's wife from suspicion." 101 Cong. Rec. 8032. The Honorable Wright Patman put the thought into a rhetorical question: "Mr. Holding Company Man, do you want to be in the race track business, the insurance business, or the theater business, or do you want to be in the banking business." (101 Cong. Rec. 8029).

The Independent Bankers of America were, then, concerned about the rapid growth of bank holding companies acquiring small banks in small towns, forcing them into competitive situations threatening their survival, with the resulting flow of money into the money centers and the loss of credit facilities formerly

available to farmers and small town businesses. Other small business organizations supported the Bill; such as the National Retail Hardware Association (101 Cong. Rec. 8023). As the brief of the Amicus Curiae filed in this cause by the Independent Bankers Association demonstrates, the Board has not followed the principles by which Congress sought to guide it in providing for the regulation of bank holding companies.

The Federal Reserve Board, at the time, "advocated that the law be extended even to one bank holding companies because 'the potential abuses resulting from combination under single control of both banking and non-banking interest could easily exist in a case in which only one bank is involved.'" (101 Cong. Rec. 8024).

The Senate Report (1956 U.S. Code Cong. & Adm. News 2482-2483, Pet. App. 3a), recited the problems as largely "The unrestricted ability of a bank holding company to add to the number of its banking units . . . and 'the combination under single control of both banking and non-banking enterprises, permitting departure from the principle that banking institutions should not engage in business wholly unrelated to banking.'"

This basic, two-fold, purpose of holding company regulation has never changed. It provides a standard which is "present and declared." *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973); See *Panama Refining Co. v. Ryan*, 293 US 288. Nothing in this standard requires, or even permits, the disapproval of a transaction designed only to preserve the control position of honest and competent management in a small independent one-office bank.

In the early sixties the Bank Merger Act, which also involved certain anti-trust considerations, was held by this Court to forbid, absolutely, any merger which had an anti-competitive effect. *U.S. v. Philadelphia Nat'l. Bank*, 374 US 321. This ruling apparently displeased Congress.

As a result, in 1966 both the Bank Merger Act (12 USC 1828) and the Bank Holding Company Act (12 USC 1841, 1842) were amended to provide, in the same language, derived from the Sherman and Clayton Acts, for the consideration of mergers and holding company acquisitions. Both statutes also provide, in the unnumbered paragraph at the end of the section, that the authority making the decision on the anti-trust considerations "shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served." (Pet. Br. p. 3). The Sherman and Clayton Acts language was used to make applicable the existing case law on those Acts, 112 Cong. Rec. 2444, and the other language was added to allow mergers or holding company transactions that would otherwise fail because of some anti-competitive effect, if the banking factors or community factors could be held to outweigh the anti-trust factors. *U.S. v. Third National Bank*, 390 US 171. The purpose of the new statute was to create a defense for mergers, not to create a new way to attack them.

In the *Third National* case this Court considered the "financial and managerial" language of the Bank Merger Act as providing a possible defense for an anti-competitive merger; the language was considered as applicable only to the particular case at hand, and as relevant only in the consideration of the two primary factors found in the statute. See 18 USC 1828(c)(5) and

12 USC 1842(c)(1) and (2). The purpose of the statute was, and remains, to avoid undue concentration of power by monopolistic or anti-competitive acts, and to prevent the use of banking power in non-banking business, but a limited defense is provided. *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

We submit that the Board errs in this case by considering the unnumbered subparagraph of 1842(c) as providing for it a separate head of jurisdiction, unrelated to the first two considerations set forth in the statute, and unrelated to any specific adverse factor arising from the completion of a proposed holding company transaction.

We also submit that financial and managerial resources are entirely relevant and material to the consideration of the Sherman and Clayton Act factors found in 12 USC 1842(c)(1) and (2). Obviously, a very weak bank with poor resources, badly located, will not be of any competitive danger to any other bank. In every case in which competitive anti-trust considerations have arisen, the capacity of the entities to compete has been precisely considered. *U.S. v. Third National Bank*, 390 US 171; *U.S. v. First National BanCorporation*, 329 F. Supp. 1003 (D.C. Col. 1971), aff'd. 410 U.S. 577; See *Cameron Financial Corp. v. Board of Governors*, 497 F.2d 841 (4th Cir. 1974), at p. 845.

The Seventh Circuit, in the opinion below, read the 1966 language, now before the Court, to have the same meaning as the very different language in the 1956 statute. [1956] U.S. Code Cong. & Adm. News, 169, 171. Pet. App. 62. There is legislative history indicating that the Board should, in granting a holding company application, consider the financial standing of the holding company. S. Rep. No. 1179, 89th Congress, Second Session, p. 12 (1966). However, that language is

as consistent with the consideration of financial factors as related to competitive and community service matters as it is with a review of financial factors apart from competitive matters.

Further, the financial factors considered are still those of the precise transaction itself; the possibility of abuses, as described in Petitioner's brief at pages 15 and 16, which are not germane to the transaction in question, were certainly not enumerated as a basis for a refusal of holding company status. The decision on the formation of a holding company is judicial, and not economic, and should be made on the facts applicable to the particular transaction, and the harm or good done by that particular transaction.

And, "it is only the words of the bill which have Presidential approval . . . it is not to be supposed that in signing a bill, the President endorses the whole Congressional Record." *Schwegman Bros. v. Calvert Distilling Co.*, 341 U.S. 384, 396. As Mr. Justice Frankfurter observed, 47 Columbia Law Rev., 527 at p. 543 (1947):

> "Spurious use of legislative history must not swallow the legislation so as to give point to the quip that only when legislative history is doubtful do you go to the statute. While courts are no longer confined to the language, they are still confined by it."

The Bank Holding Company Act was, most plainly, passed, amended, and then applied to one bank holding companies to avoid "concentrating the commercial bank facilities in a particular area under a central control" and to avoid a "combination, again under single control of banking and non-banking enterprises." (1970) U.S. Code Cong. & Adm. News, 5520. The reasons are plain, and often repeated. (Ibid. 5521). In none of the

legislative history is there any specified intent to convey to the Board any power to deny holding company status which is intended to be and is an intelligent and useful business step in the logical development of a banking picture, in the absence of some adverse competitive factor, factor relating to the control of non-banking entities by the holding company, or some factor of harm which arises from the transaction itself.

The legislative history of the Bank Merger Act is similar; the "primary emphasis" is to the "competitive factor." 112 Cong. Rec. 2441 (2/8/66).

We do, accordingly, contend that the Board has no authority to deny bank holding company status in the absence of some anti-competitive or anti-cartel consideration, or for any reason not precisely related to and caused by the proposed transaction itself. *Western Bancshares v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

We do not suggest that bank mergers—or the formation of holding companies—should be altogether without financial supervision. That is plainly supplied by the Comptroller of Currency, in the case of national banks, and by the State supervisory authorities in the case of state banks. The Federal Deposit Insurance Corporation is also involved.

This is illustrated by the way in which bank holding company cases come before the Courts of Appeal. If the Comptroller says "no", the applicant has the right to an evidentiary hearing. 12 USC 1842(b). But if the Comptroller says "yes," then the holding company applicant has no right to an evidentiary hearing, and the case is decided on the documents. This is because, as it was then conceived, there could be no objection on banking questions if the direct supervisor said "yes." It was not

contemplated that the Board would have banking objections—only that it would have the anti-trust and cartel type objections in which its economic expertise is appropriately respected.

III.

THE DECISION OF THE BOARD WAS ARBITRARY AND CAPRICIOUS.

The Board denied holding company status in this case, against the approval of the direct regulatory authority who examines the Bank (App. 51), and against the recommendation of the Federal Reserve Bank of Chicago, which made an exhaustive and favorable report considering every factor. (App. 19). This decision was made without any facts other than those in the application and in the report of FRB Chicago.

The Board was, concerned about what it called "acquisition debt." (Pet.App. 25a).

The FRB Chicago report recognized that "[T]he current debt position of the principals is directly tied to the acquisition of additional control of Bank, and at the same time exercising this control to improve its daily operation and general condition. We believe this control is fundamental to the current well being of Bank, thus, it seems inappropriate to penalize the principals for their accomplishment using debt, by denying their plans for reorganization when their past actions generally support approval of the proposal. The holding company structure will enhance Bank's prospects for capital retention." (App. 23).

Management is outstanding, as the Board agrees, and has guided the Bank to "its now favorable condition." (Pet. App. 19a).

And, when the question of whether or not the hope of holding company status was a factor in the individuals buying out the tainted group, FRB Chicago noted that "Considering that principals of Applicant (First Lincolnwood) were attempting to acquire control from the Projansky group, which had been responsible for the Bank's earlier problems, we would not consider it unusual that some encouragement may have been offered; nevertheless, we feel certain that no firm commitments would have been made." (App. 36). Plainly, the buy-out of the tainted interests was made with at least a rational hope that the way to repayment would be eased by the allowance of holding company status. It was surely hoped that any rejection would, at least, have a basis in the transaction itself.

Under these circumstances, and upon these facts, a holding company transaction's having none of the potentials for harm mentioned in the Board's brief, and having no effect whatever on any community consideration or financial situation, except the enhancement of the Bank's capital, should have been allowed; to deny it is arbitrary and capricious, because it has no rationally discernable reason. 5 USC 706(2)(A). See *First National Bank of Catawba County v. Wachovia Bank & Trust Co.*, 448 F.2d 637 (4th Cir. 1971); *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

We add that the Board's own precedents would appear to require approval of this application. The Board said, in *Central States Bancorp., Inc.*, 39 Fed. Reg. 31952, that

> "The Board has been relatively liberal in the standards it has applied in cases where a current or prospective owner-chief executive is establishing, or has established, a one bank holding company to hold the direct equity interest in his bank. Such relative liberality is regarded as in the public interest in order to facilitate management succession

on the community level at the nation's many smaller independent banks."

Such holding companies often have acquisition debt, and often pay that debt from the dividends and tax transfer payments allowed by law. *Commercial Bank & Investment Co.*, 39 Fed. Reg. 31953; *Drummond Bancshares*, 39 Fed. Reg. 36063.

The effect of the allowance of holding company status is to transform the ownership of the Bank from a voting trust, against which there is debt, from which, presumably, there flows pressure for dividends, to a holding company, which will have a greater ability to pay that debt from the dividends as are now available to the holding company.

The Board argues that the Bank is better off if owned by tax-pressed individuals rather than by a relatively tax free holding company enjoying an enhanced ability to repay debt. Such a decision is so far from logic as, we submit, to be considered arbitrary and capricious. And, the Board is acting out its economic policies, we contend, and not deciding the case on the basis of the record in the case itself.

There is nothing in the statute which says that the Board may specify capital requirements for a holding company. Congress should not be held to have required that which it did not require, and the assumption of administrative authority to make requirements that are not part of the statute should not be allowed. See: *NLRB v. The Boeing Co.*, 412 US 67, 72, 73. Powers in the Board should not be presumed, and it is the decision of this Court, and not of the Board, whether or not the Board's interpretation of its statutory authority is correct. *Volkswagenwerk v. Federal Maritime Commission*, 390 U.S. 261, 272. We submit that this decision

is plainly reversible as beyond the scope of the Board's power, under 5 USC 706(2)(C), and that the result below is correct.

IV.

THE FORMATION OF A HOLDING COMPANY IS DIFFERENT FROM THE FORMATION OF A BANK.

A commercial bank is an entity that receives deposits; the public must trust it, it must be insured, it will be closely regulated, and it has a defined capital structure. See, e.g., 12 USC 1816. In a "decentralized system of community banks"[8] it is essential that a proposition to form a new bank be analyzed for the probabilities of success, lest the public and the FDIC be induced to place reliance in a venture that must fail. The authorities cited at pages 28 and 29 of Petitioner's Brief demonstrate this point. But, a bank holding company, especially a one-bank holding company such as is involved in this case, is entirely different. Its entire business future is based on the success of the Bank, which was authorized to open its office in 1955, and its resulting ability to repay its debt, which was created five years ago.

We do not propose the formation of a new bank to receive the deposits of the public, and the compelling reasons for examination of the probabilities of the success of such an entity do not exist in this case.

We do propose to transfer ownership of an old bank from unregulated ownership through a voting trust to regulated ownership through a bank holding company. See 12 USC § 1818(3). The various statutes dealing with the requirements for opening a new bank plainly refer to something entirely different from this transaction,

[8] *U.S. v. Philadelphia National Bank*, 374 U.S. 321, 325.

and the Board should not rely on those statues as authority for its actions here. The holding company will not receive deposits; it will not make loans; it will not be insured by the FDIC, and it will do no more than the voting trust does now; vote the stock entrusted to it at the annual meeting of the Bank.

To the extent that it may raise money by the sale of debentures, if that should occur, it must comply with the Securities laws of the State and the United States; that in itself is a formidable regulation.

The Board's argument that, because certain matters must be considered in the formation of a bank, those same matters must be considered in the formation of a one-bank holding company is plainly not based upon the realities of the case. The *ownership* of the entity is different from the entity itself, and should be so recognized in any analysis of the facts.

The Board says that if, in its view "the enterprise would be too thinly capitalized" that it is entitled to withhold approval; it has no standards for "thinly capitalized," and does not claim that there are any such standards anywhere. And, it argues from statutory precedent regulating the formation of deposit receiving entities. The distinction is plain.

The Board argues, from *Anderson v. Abbott*, 321 U.S. 349, (Pet. Br. p. 25) that it has the right to claim that a one bank holding company should be so capitalized as to be a source of strength to its bank. The *Anderson* case was decided under the one-hundred per cent liability assessment statute, which permitted the receiver of an insolvent bank to sue the shareholders for the par value of their stock. See 12 USC 64. That statute has been supplanted by 12 USC 64a, and the law applied in the *Anderson* case is no longer the law. By specific enact-

ment of Congress the shareholders of a national bank are no longer statutorily obligated to be a source of strength to the bank, and no such requirement should be presumed.

We do agree that the Board interprets the statute to favor its own position, as it argues. But, it has been reversed before when its own interpretation contradicted a judicial view of its statutory definitions. See *Patagonia Corp. v. Board of Governors*, 517 F.2d 803 (9th Cir. 1975). We contend that its interpretation of its powers here is too generous to its own position, and is surely not binding upon the Court. It was properly limited in the opinion of Judge Fairchild and the other members of the Court of Appeals.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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